

Grecian tragedy- redux

Just when the world appeared to be on the way to recovery after suffering from one of the worst bouts of economic hardship, the crisis at Greece has emerged as a party pooper. Thanks to greater financial interconnectedness, the upheaval in Athens has the ability to impact not just the European Union ; but even distant countries like India which have negligible economic relations with the Mediterranean country might be impacted too. Further the crisis at Greece has not been limited to the currency markets; alternative investment markets like gold too have felt the tremors of the Hellenic tectonic movements in the form of increased volatility of price.

Greece has an ancient and rich past and in many areas like warfare, philosophy, empire building, culture and economics it was the harbinger of modern ideas and concepts. However, post World War, it has never been a strong contender for economic supremacy. Thus its move to join the European Monetary Union in 1995 was seen as an attempt to piggyback on the strength of the EU's Common currency, unified capital markets and free trade. Interestingly, however, today this very membership to the EU is like a Damocles sword which is blocking the country's attempt to contain the crisis.

Throughout the period of its membership to EU, the country had never adhered to the stringent norms of fiscal deficit, external indebtedness and inflation that was required from all members. During the credit boom of 2005, there had been a surfeit of capital into Greece like other countries but this had merely fuelled huge fiscal expenses and runaway inflation without any real growth. The first signs of strain were felt when the present administration confessed to manipulating the public accounts by way of complex derivatives to under report actual public debt. When the true (and higher) public debt figure came into light, it created a panic among investors exposed to Greece. This was manifested in higher spreads on bonds and with a recession already underway led to an imminent prospect of sovereign default. Speculative attacks on the currency further compounded the problem.

The options before Greece are painful and unpalatable. In fact there are not too many options. A loose monetary policy would have allowed to inflate away its debt. Its membership to EU leaves it with no leeway for monetary and external management to manage the crisis barring fiscal tightening. Devaluing its drachma to restore competitiveness would have been a good solution but that would entail leaving the EU. But a weak nation would avoid leaving the aegis of a strong economic club. Fiscal contraction is not only politically unacceptable (especially since 40% of the nation's work force are public workers) but makes bad economic sense since it will reduce taxes, an important source of revenue needed to shore its public finances. Other economically strong members of the EU are hesitant to come to the nation's aid since they view Greece to be a chronically irresponsible nation. The assistance package of nearly one trillion dollars is seen to be too less when compared with a fiscal deficit of 13% of GDP and public debt of 140% of GDP. In the absence of sufficient assistance from either the EU or IMF, the only way out would be restructuring of existing debt or outright default. Thus Greece might win the battle but in the process will lose the war.

In this context, praise must be reserved for the exemplary handling of the near sovereign default that India faced in 1991. India neither defaulted nor restructured its debt; rather it was a combination of some painfully short term measures (like mortgage of the nation's gold) and prudent long term steps (like building of forex reserves and discipline in fiscal and forex management) aided with increased household savings (as against profligacy of the Greeks), that helped India emerge from the crisis.

Thus both the present crisis at Greece and the past crisis in India in 1991 teach us important lessons for the future. It is our duty and responsibility as Cost and Management Accountants to learn from these episodes, avoid making the same mistakes and contribute to better serving the nation.